Introduction to Tax

What is it?

Taxation is a system created by a government (of a country) to generate income from its citizens. The main objective of it from the government's perspective is to take the income received and provide services to citizens, expand or enhance infrastructure or even use the income to pay off its debts (national debt.)

It is a system that levies a charge on citizens' income in order to provide various services e.g. health care, motorway construction, benefits etc.

Taxation is vital to a country's development as without it, there would be no steady income stream and therefore no resources to help improve the standard of life that it provides to its citizens.

Cradle to the grave

This term is a good description of the impact taxation has on its citizens within the United Kingdom (as well as other countries,) it is essentially unavoidable if you generate any source of income e.g. from the moment your parents set up savings account when you are born to the moment where your give away all that you own before you pass away

But how?

Well land tax was introduced in the late 17th century in the UK, and the country was quick to realise the revenue potential.

In 1799 Income tax was introduced, to help finance the purchase of equipment and weapons for the Napoleonic wars. It was introduced originally in 5 schedules:

- Schedule A (tax on income from UK land)
- Schedule B (tax on commercial occupation of land)
- Schedule C (tax on income from public securities)

- Schedule D (tax on trading income, income from professions and vocations, interest, overseas income and casual income)
- Schedule E (tax on employment income)

It was abolished after the peace treaty and then reintroduced when tensions resurfaced (and when it did it already included a sixth schedule "dividend income.") However afterwards was abolished again after the "battle of waterloo".

The pattern essentially became whenever the country needed financing it would introduce/reintroduce tax legislation into the country. As time went on the United Kingdom needed more financing and therefore (you guessed it) more tax legislation was introduced, covering more sources of income and transactions than its predecessor.

Fast forward to where we are now and taxation is everywhere:

- Charged on employment income
- Charged on savings income (interest your receive)
- Charged on Dividend income
- Charged on sales of assets (like real estate)
- Charged on profits of self-employed individuals and companies
- Charged on death (on the assets you own at the time of your death)
- Charged on perks (company cars, company accommodation, loans etc. for its employees)
- Charged on everyday goods purchased and sold (cloths, foods, etc.)

A bit Harsh?

Even though taxation is all around us, it is not a "take all and give nothing relationship." Yes the country levies the charge to its citizens to help finance its projects, but at the same time it uses these funds to help better itself for its citizens e.g. providing top range healthcare, building safe roads for commuting, to help shelter those who cannot afford a roof over their heads etc. Secondly, tax system gives us certain advantages in the form of tax free income, tax exemptions, tax reliefs, different tax rates for income etc.

How am I affected by taxation?

Taxation is charged on a variety of income types, and these types of income are split into categories within the tax system, and they are as follows:

Income Tax:

- For individuals who are in employment
- For individuals who are self-employed (sole trader)
- For individuals who receive savings, dividend, pension, trust, property income

Corporation Tax

- For companies that receive trading, property income, investment income and/or income from sale of assets owned.

Inheritance tax

- For individuals who gift their personal assets to other individuals and/or trusts during their lifetime
- For individuals who plan to gift their assets upon their death via a will/deed

Capital gains tax

- For individuals/entities who dispose (sells, transfers, gifts etc.) personal or business assets to another individual or entity (regardless of profit intentions)

- For individuals/entities who dispose (sells, transfers, gifts etc.) a part(s) of a personal or business asset(s) to another individual or entity.

Why is it important

First and foremost taxation compliance is essential as failure to comply with tax legislation would lead to penalties, fines, interest charges and possible criminal conviction irrespective of which tax category you fall under.

Secondly having a general understanding of how tax may affect you, is beneficial as it would help determine truly how much cash is at your disposal. Without having the general knowledge of the tax system (irrespective of the country,) forecasts and budgets (whether for yourself or for a business) could potentially be misleading.

Thirdly, financial planning is important for all individuals, families and entities alike. A basic knowledge base of how the tax system operates, can lead to possible tax savings, better investment decisions and to help ensure one does not potentially live above his/her means.